

Message Text

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ACTION ARA-20

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CIAE-00 COME-00 FRB-03 INR-11 NSAE-00 XMB-07 OPIC-12

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TAGS: EFIN CI EMIN

SUBJ: DEVALUATION OF EXCHANGE RATE FOR BIG COPPER

1. SUMMARY. CENTRAL BANK HAS ELIMINATED SPECIAL EXCHANGE RATE FOR BIG COPPER BY MERGING IT WITH BROKERS RATE. CODELCO WILL NOW IMPORT AND EXPORT AT SAME RATE AND ITS PROFIT PICTURE WILL IMPROVE AS RESULT. REVENUE PREVIOUSLY CAPTURED BY CENTRAL BANK WILL NOW FLOW TO CODELCO, WITH PROBABILITY THAT ONLY PART WILL BE RECOUPED LATER BY GOC THROUGH TAXATION. THERE WILL BE TENDENCY FOR INCREASED COSTS ON PART OF CODELCO AND SOME INCREASE IN INFLATION DUE TO CODELCO'S HIGHER ESCUDO INCOME. END SUMMARY.

2. EFFECTIVE AUGUST 6 CENTRAL DEVALUED EXCHANGE RATE RECEIVED BY LARGE COPPER MINES FROM 550 ESCUDOS TO 860 ESCUDOS PER DOLLAR, THUS ELIMINATING SEPARATE RATE BY MERGING IT WITH BANKERS RATE.

3. PREVIOUS POLICY OF HAVING EXPORT EXCHANGE RATE FOR BIG COPPER (THE FIVE NATIONALIZED MINES OF GRAN MINERIA) LESS FAVORABLE THAN BANKERS RATE AT WHICH MOST BUSINESS

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TRANSACTIONS TAKE PLACE WAS DESIGNED TO CAPTURE PROFITS

FOR CENTRAL GOVT. RATHER THAN LETTING THEM PASS TO SEMI-AUTONOMOUS COPPER CORPORATION (CODELCO). RATIONALE FOR THIS WAS THAT WITH LESS INCOME COPPER MINES WOULD BE FORCED TO ECONOMIZE AND THAT CENTRAL GOVT. WOULD USE EXCHANGE PROFITS TO FINANCE PART OF BUDGET DEFICIT.

4. ACCORDING TO CODELCO SOURCES, CORPORATION HAS BEEN FIGHTING AGAINST THIS POLICY EVER SINCE POLICY WAS ESTABLISHED BY INCOMING GOVERNMENT SEVEN MONTHS AGO. CODELCO CLAIMS THAT DISCRIMINATORY EXCHANGE RATE HAS HAD DELETERIOUS EFFECTS ON CODELCO'S ABILITY TO MAKE RATIONAL MANAGEMENT DECISIONS BECAUSE IT IS DIFFICULT TO TELL HOW WELL OR BADLY MINING OPERATIONS ARE GOING. AN EXAMPLE GIVEN IS THAT IMPORTED GOODS APPEAR ARTIFICIALLY CHEAP AND NATIONAL PRODUCTS ARTIFICIALLY EXPENSIVE TO CODELCO, SO THAT CORPORATION WILL TEND TO IMPORT PRODUCTS EVEN WHEN IN REAL TERMS CHILEAN PRODUCT MAY BE CHEAPER. ANOTHER PROBLEM IS COMPUTING EXPECTED VALUE OF INTENDED INVESTMENT WHEN BENEFITS WILL BE IN

FOREIGN EXCHANGE BUT THE COSTS WILL LARGELY BE IN ARTIFICIALLY HIGH PRICED ESCUDOS.

5. SOME CENTRAL BANK OFFICIALS ARE REPORTED TO BE DISTURBED AT RULING ON GROUNDS THAT CENTRAL GOVT. REVENUES WILL DECREASE RADICALLY AND HIGHER FLOW OF ESCUDOS TO CODELCO WILL CONSTITUTE EXPANSION OF MONEY SUPPLY AND LEAD TO FURTHER INFLATION. CODELCO OFFICIALS INSIST THAT THERE SHOULD BE NO SUCH EFFECT AS THEY AGREE THAT GOC COULD AND SHOULD TAX AWAY ALL PROFITS.

6. COMMENT. CODELCO'S ARGUMENT HAS SOME MERIT ALTHOUGH IT COULD CONCEIVABLY ELIMINATE ECONOMIC DISTORTIONS OF SPECIAL RATE THROUGH USE OF SHADOW PRICES AT BROKERS EXCHANGE RATE. ON OTHER HAND, CENTRAL BANK WILL NOW HAVE LOSS CONTROL OVER MONETARY EXPANSION. ALSO, MANAGERS OF MINES WILL BE TEMPTED TO LET THEIR COSTS INCREASE (SUBJECT TO GOC OVERVIEW OF BUDGETS). THE MEASURE COULD THEREFORE CAUSE TRANSFER OF RESOURCES TO COPPER MINING SECTOR FROM PUBLIC SERVICE SECTORS. TO EXTENT THAT SUCH INCREASED COSTS ARE FOR NEEDED MAINTENANCE OR INVESTMENT, LONGER TERM ECONOMIC IMPACT SHOULD

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BE FAVORABLE. IF EXPENDITURES ARE IN FOREIGN EXCHANGE THERE WOULD BE NO ADDITIONAL INFLATIONARY IMPACT. HOWEVER, IT IS UNLIKELY THAT THIS WILL ALWAYS BE THE CASE, AND THE MINES WILL NOT BE COMPLETELY ABLE TO RESIST THE TEMPTATION TO PAD COSTS.
POPPER

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